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In the Supreme Court of the United States

OCTOBER TERM, 1967.

No. 1031

HENRY H. BENDER and MYRTLE BENDER,

Petitioners,

vs.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI
To the United States Court of Appeals
For the Sixth Circuit.

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OPINIONS BELOW.

The Memorandum Opinion of the District Court is reported at 246 F. Supp. 189 and is printed in the Appendix at p. 7a.

The opinion of the Court of Appeals is reported at ____ F. 2d ____, and is printed in the Appendix hereto at page 23a.

The order denying Petition for Rehearing is printed in the Appendix hereto at page 32a.

JURISDICTION.

Jurisdiction of this Court is invoked under 28 U. S. C. Section 1254(1) and 28 U. S. C. 2101. The judgment of the Court of Appeals was entered on September 28, 1967. The Order for denying the Petition for Rehearing was entered on November 13, 1967.

QUESTIONS PRESENTED FOR REVIEW.

First Question.

May a lessor of real property who, in order to preserve an existing lease and secure a renewal thereof, purchases adjacent improved real property, with the intent to demolish the buildings thereon in order to make the acquired property suitable for the lessee's use, amortize his expenditures over and above the appraised fair market value of the raw land, as an expense incurred for the production or collection of income or for the management, conservation or maintenance of property held for the production of income?

Second Question.

May an Appellate Court ignore the normal rules of construction of statutes and regulations and decide that a Regulation under a statute dealing with a specific subject, namely "Losses," is to be applied generally to all demolitions on real property?

Third Question.

May an Appellate Court reverse a finding of a material fact and rely on a presumption to reverse Trial Court?

STATUTES INVOLVED.

The relevant statutes and regulations are:

26 U. S. C. (1958 Edition) Section 162;
26 U. S. C. (1958 Edition) Section 165;
26 U. S. C. (1958 Edition) Section 167;
26 U. S. C. (1958 Edition) Section 212;
26 C. F. R. § 1.165-3;
26 C. F. R. § 1.167(a)-(4);
26 C. F. R. § 1.167(a)-(5).

The pertinent provisions of the above statutes and regulations are set forth on pages 1a to 7a, inclusive, Appendix A.

STATEMENT OF THE CASE.

The taxpayers, Petitioners in this case, own an 80% interest in five lots in Toledo, Ohio, which had been leased to the Kroger Company for a grocery store. When the time approached for renewal, Kroger notified the lessors that additional parking was essential for the renewal of the lease. The lessors then negotiated for the purchase of two adjoining lots on which three houses were located. After considerable negotiation, taxpayers purchased the lots and buildings for approximately $75,000 plus a real estate commission of $3,620 and a legal fee of $75.00. Taxpayers demolished the buildings at a cost of $1,790.00. The Kroger Company renewed the lease on terms which compensated lessors for the cost of acquisition of the parking lot property.

Taxpayers on the 1959, 1960 and 1961 income tax returns amortized the cost of the demolition, the building cost, real estate commission and legal fees on the basis of the ten-year term of the renewed lease.

The Internal Revenue Service disallowed the deductions on the ground that the expenditures were capital expenditures which had to be allocated solely to the land.

The District Court held that taxpayers purchased the land and demolished the buildings for the purpose of obtaining a renewal of the lease on adjoining property and that therefore the cost of the demolished buildings was attributable to the expenses of acquiring a leasehold and was deductible under Section 212 and Section 162 of Internal Revenue Code.

The Appellate Court reversed the findings and held that Regulation 1.165-3 entitled "Demolition of Buildings" was applicable.

REASONS FOR ALLOWANCE OF THE WRIT.

The question of allowance as a deduction from income in determining income tax liability of demolition expenses incurred in the improvement of property for a tenant is a matter of great public interest in these times when parking space for automobiles is constantly becoming more of a problem. The acquisition of buildings solely for the purpose of their demolition to make room for car parking space is a matter which will constantly arise within the next several years. It is in the public interest that landlords of buildings serving the public provide adequate parking space. In this case the landlord of a tenant in the grocery store business acquired adjoining land and demolished buildings thereon to provide parking space for the tenant's customers in order to retain the tenant on the leasehold.

There is a difference of opinion between the 5th Circuit Court of Appeals (*Camp Wolters Land Company vs. Commissioner,* 160 F. 2d 84) and this case (*Bender vs.*

United States) decided by the 6th Circuit Court of Appeals. Due to this conflict of the Circuits and the public interest in this question, consideration of this case by the Supreme Court will provide a guide for the Appellate Courts and the District Courts in disposing of other cases involving this kind of problem.

FIRST QUESTION.

May a lessor of real property who, in order to preserve an existing lease and secure a renewal thereof, purchase adjacent improved real property, with the intent to demolish the buildings thereon in order to make the acquired property suitable for the lessee's use, amortize his expenditures over and above the appraised fair market value of the raw land, as an expense incurred for the production or collection of income or for the management, conservation or maintenance of property held for the production of income?

The Appellate Court decided that the total cost of realty shall be allocated to the land alone when at the time of purchase the buildings thereon are intended to be demolished (Appendix, pages 26a, 27a). The Court cited as authority *Providence Journal Company vs. Broderick,* 104 F. 2d 614 (C. A. 1, 1939); *Liberty Baking Company vs. Heiner,* 37 F. 2d 703 (C. A. 3, 1930); *Montgomery Company vs. Commissioner,* 330 F. 2d 950 (C. A. 6, 1964); *Lesser vs. Commissioner,* 42 T. C. 688 (1964), affd. 352 F. 2d 789 (C. A. 9, 1965), cert. denied 384 U. S. 982 (1966).

All of the cases mentioned involved claims for losses due to the demolition. They are readily distinguishable from the case before this Court where the taxpayer claimed no losses but rather expensed over the term of the leasehold of his tenant the costs of acquiring the demol-

ished buildings and their removal. The expense of acquiring a tenant of a leasehold is a deductible expense. *The Trustee Corporation vs. Commissioner,* 42 T. C. 32 (Dec. 26823); *Harry Latter, et al., vs. Commissioner,* 20 T. C. M. 336 (1961); *World Publishing Company vs. Commissioner,* 299 F. 2d 614 (8 Cir. 1962); *Camp Wolters Land Company vs. Commissioner,* 160 F. 2d 84.

Congress recognized that expenses for the production or collection of income or for the management, conservation or maintenance of property held for the production of income were proper deductible expenses when it enacted 26 U. S. C. Section 212 which reads in part as follows:

> "In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year * * * (1) for the production or collection of income; (2) for the management, conversation, or maintenance of property held for the production of income; * * *."

The taxpayer, Henry H. Bender, had been in the business of renting his improved real estate lots numbers 149 through 153 in Knower's Addition, Toledo, Ohio, to the Kroger Company for a grocery store from January, 1953. In June of 1959 about a year before the lease was to expire, Kroger advised the lessor that the lease would not be renewed unless the lessor acquired certain adjoining property, lots 230 and 231, level the buildings thereon and make the lots available to the lessee for use as a parking lot. Mr. Bender, desiring to keep his tenant, purchased the desired adjoining property on November 9, 1959, demolished the buildings, and cleared the land for a parking lot. Kroger Company signed a new lease which provided for an increase in rental to cover the additional land and to reimburse the lessor over the ten-year new lease period for the expense of the demolished buildings.

The Trial Court found that the cost of acquiring the buildings and demolishing them was an ordinary and necessary expense to the taxpayer in carrying on his business of renting improved real estate.

SECOND QUESTION.

May an appellate court ignore the normal rules of construction of statutes and regulations in deciding that a Regulation under a statute dealing with a specific subject, namely "Losses," is to be applied generally to all demolitions on real property?

The Government argued before the Court of Appeals that Section 165 of the Internal Revenue Code and the Regulation thereunder, Section 1.165-3, relating to demolition of buildings prohibited the taxpayer from amortizing his demolition losses as business expenses. If the taxpayer had claimed these expenses as losses, there is no doubt that they would be disallowed under Section 165 and Regulation 1.165-3. The taxpayer considered the demolition cost as expenses of acquiring a ten-year renewal of a leasehold on adjoining property and therefore allocated their costs as business expenses over the term of the renewal. He considered such cost as properly deductible under Section 212 and/or Section 162 of the Internal Revenue Code.

The Court of Appeals decided that Regulations 1.165-3 were broad enough in scope to prohibit the amortization of all demolition costs if at the time the property was purchased the buyer intended to demolish the buildings thereon.

Under the normal rules of construction of tax statutes and regulations the Treasury may not make an arbitrary or unreasonable regulation nor can it restrict or enlarge the scope of a statute. *Mertens Law of Federal Income*

Taxation, Par. 3.21; *United States vs. Zions Savings and Loan Association,* 313 F. 2d 331 (C. A. 10, 1963). In holding that the Regulation 1.165-3 covers all demolitions the Court of Appeals has enlarged the statute Section 165 far beyond the ordinary meaning of the language of the law. The statute itself does not mention demolitions at all. It discusses only "Losses." The Regulation in setting up rules for losses due to demolition properly fills out the details of the statute. However, when the Regulation is interpreted to apply to all demolitions regardless of whether they are losses or not, it would seem that the interpretation goes beyond the intent of Congress and therefore violates the statutory rules of construction and results in the exercise of a non-delegable legislative function. It has been held that such action is invalid and unenforceable.

In *Empey vs. United States,* United States District Court, District of Colorado, 67-2 U. S. T. C. 9638, the Court held that the Regulation of the Treasury Department pertaining to Section 7701(a) was invalid because the statute defines "partnerships" as "unincorporated" organizations and that by this definition "incorporated" organizations were necessarily excluded. The Court therefore found that the regulation was ineffective and contrary to the statute. The Court said that the Treasury Regulations were inconsistent with the statute and the judicial construction thereof; that the Regulations constituted the exercise of a non-delegable legislative function and are invalid and unenforceable, citing *A. L. A. Schecter Poultry Corporation v. United States,* 295 U. S. 495; *Panama Refining Company v. Ryan,* 293 U. S. 388; and *United States v. Zions Savings and Loan Association,* 313 F. 2d 331.

The United States Supreme Court in *Crane vs. Commissioner,* 331 U. S. 1, 6, said that the words of statutes including Revenue Acts should be interpreted where pos-

sible in their ordinary everyday sense. Also see *Hanover Bank vs. Commissioner,* 369 U. S. 672, 687. Using this rule of construction, Regulation 1.165-3 is limited to "Losses." To hold otherwise and apply it to demolitions generally would be a strained construction contrary to the rules of judicial interpretation.

THIRD QUESTION.

May an Appellate Court reverse a finding of a material fact and rely on a presumption to reverse the District Court?

The Trial Court's findings of fact are that the taxpayers purchased the subject real estate and removed buildings therefrom for the purpose of securing a lease renewal from the Kroger Company on adjoining property. The new lease was a wasting asset. The District Court concluded therefore that the cost of obtaining the lease was amortizable over the lease term.

When dealing with questions of fact, the question is whether there was any evidence to sustain the conclusion reached by the Court below. A finding of fact by the Trial Court cannot be rejected on appeal where there was sufficient evidence to sustain it and where it is not contrary to the preponderance of the evidence. 3 *Am. Jur.* 900; *Memorial Hospital Association vs. Pacific Grape Products Company,* 45 Cal. 2d 634, 50 A. L. R. 2d 442, *Halsell vs. Renfrow,* 202 U. S. 287. And all reasonable inferences must be indulged to uphold it, if possible. *Kansas City Stockyards Co. of Maine vs. Anderson,* 36 A. L. R. 2d 1, 199 F. 2d 91, *Kaiser Motors Corp. vs. Savage,* 229 F. 2d 525.

Section 212 permits deductions for expenses incurred in the production or protection of income. Since the Trial Court found as a fact that the demolition expenses were

incurred for the production and protection of income from a wasting asset (the Kroger lease) the expenses should be allowed to be amortized as in *Camp Wolters Land Company vs. Commissioner,* 160 F. 2d 84 (C. A. 5). The taxpayers acquired the property in question and demolished the buildings thereon for the sole purpose of obtaining a renewal of the lease with Kroger Company. At no time did the taxpayers consider that they were incurring losses when they demolished the buildings and they never claimed any losses on their income tax returns. The expenditures for acquisition of the buildings and their demolition were business expenses incurred for the purpose of renewing the Kroger lease. It was for the production and conservation of income. Allowance of this business expense in no way violates the presumption that when a person buys land with improvements which he intends to demolish, he in effect pays only for the land. The presumption of this intent is overcome when proof is established that the intent was, not to acquire the land for itself, but to obtain the renewal of an existing leasehold on adjoining property.

For the foregoing reasons it is urged that this Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

JOHN KENNEDY LYNCH,
Counsel for Petitioners.

APPENDIX A.

STATUTES AND REGULATIONS.

Internal Revenue Code of 1954:

SEC. 162.

(a) In General—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered;

(2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business; and

(3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity * * *

(26 U. S. C. 1958 ed., Sec. 162.)

SEC. 165. LOSSES.

(a) *General Rule.*—There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

(b) *Amount of Deduction.*—For purposes of subsection (a), the basis for determining the amount of the deduction for any loss shall be the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property.

(c) *Limitation on Losses of Individuals.*—In the case of an individual, the deduction under subsection (a) shall be limited to—

(1) losses incurred in a trade or business;

(2) losses incurred in any transaction entered into for profit, though not connected with a trade or business; * * *

* * * * *

(26 U. S. C. 1958 ed., Sec. 165.)

SEC. 167. DEPRECIATION.

(a) *General Rule.*—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

* * * * *

(f) *Basis For Depreciation.*—The basis on which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 1011 for the purpose of determining the gain on the sale or other disposition of such property.

* * * * *

(26 U. S. C. 1958 ed., Sec. 167.)

SEC. 212.

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year—

(1) for the production or collection of income;

(2) for the management, conservation, or maintenance of property held for the production of income; or

(3) in connection with the determination, collection, or refund of any tax.

(26 U. S. C. 1958 ed., Sec. 212.)

Treasury Regulations on Income Tax (1954 Code):

§ 1.165-3. *Demolition of buildings.*

(a) *Intent to demolish formed at time of purchase.* (1) Except as provided in subparagraph (2) of this paragraph, the following rule shall apply when, in the course of a trade or business or in a transaction entered into for profit, real property is purchased with the intention of demolishing either immediately or subsequently the buildings situated thereon: No deduction shall be allowed *under section 165(a)* on account of the demolition of the old buildings even though any demolition originally planned is subsequently deferred or abandoned. The entire basis of the property so purchased shall, notwithstanding the provisions of § 1.167(a)-5, *be allocated to the land only.* Such basis shall be increased by the net cost of demolition or decreased by the net proceeds from demolition.

(2) (i) If the property is purchased with the intention of demolishing the buildings and the buildings are used in a trade or business or held for the production of income before their demolition, a portion of the basis of the property may be allocated to such buildings and depreciated over the period during which they are so used or held. The fact that the taxpayer intends to demolish the buildings shall be taken into account in making the apportionment of basis between the land and buildings under

§ 1.167(a)-5. In any event, the portion of the purchase price which may be allocated to the buildings shall not exceed the present value of the right to receive rentals from the buildings over the period of their intended use. The present value of such right shall be determined at the time that the buildings are first used in the trade or business or first held for the production of income. If the taxpayer does not rent the buildings, but uses them in his own trade or business or in the production of his income, the present value of such right shall be determined by reference to the rentals which could be realized during such period of intended use. The fact that the taxpayer intends to rent or use the buildings for a limited period before their demolition shall also be taken into account in computing the useful life in accordance with paragraph (b) of § 1.167(a)-1.

(ii) Any portion of the purchase price which is allocated to the buildings in accordance with this subparagraph shall not be included in the basis of the land computed under subparagraph (1) of this paragraph, and any portion of the basis of the buildings which has not been recovered through depreciation or otherwise at the time of the demolition of the buildings is allowable as a deduction under section 165.

* * * * *

(b) *Intent to demolish formed subsequent to the time of acquisition.* (1) Except as provided in subparagraph (2) of this paragraph, the loss incurred in a trade or business or in a transaction entered into for profit and arising from a demolition of old buildings shall be allowed as a deduction under section 165(a) if the demolition occurs as a result of a plan formed subsequent to the acquisition of the buildings demolished. The amount of the loss shall be the adjusted basis of the buildings demolished increased by the net cost of demolition or decreased by the net proceeds

from demolition. See paragraph (c) of § 1.165-1 relating to amount deductible under section 165. The basis of any building acquired in replacement of the old buildings shall not include any part of the basis of the property demolished.

(2) If a lessor or lessee of real property demolishes the buildings situated thereon pursuant to the requirements of a lease or the requirements of an agreement which resulted in a lease, no deduction shall be allowed to the lessor under section 165(a) on account of the demolition of the old buildings. However, the adjusted basis of the demolished buildings, increased by the net cost of demolition or decreased by the net proceeds from demolition, shall be considered as a part of the cost of the lease to be amortized over the term thereof.

* * * * *

(26 C.F.R., § 1.165-3.)

§ 1.167(a)-4. *Leased property.*

Capital expenditures made by a lessee for the erection of buildings or the construction of other permanent improvements on leased property are recoverable through allowances for depreciation or amortization. If the useful life of such improvements in the hands of the taxpayer is equal to or shorter than the remaining period of the lease, the allowances shall take the form of depreciation under section 167. See §§ 1.167(b)-0, 1.167(b)-1, 1.167(b)-2, 1.167(b)-3, and 1.167(b)-4 for methods of computing such depreciation allowances. If, on the other hand, the estimated useful life of such property in the hands of the taxpayer, determined without regard to the terms of the lease, would be longer than the remaining period of such lease, the allowances shall take the form of annual deductions from gross income in an amount equal to the

unrecovered cost of such capital expenditures divided by the number of years remaining of the term of the lease. Such deductions shall be in lieu of allowances for depreciation. See section 162 and the regulations thereunder. See section 178 and the regulations thereunder for rules governing the effect to be given renewal options in determining whether the useful life of the improvement exceeds the remaining term of the lease where a lessee begins improvements on leased property after July 28, 1958, other than improvements which on such date and at all times thereafter, the lessee was under a binding legal obligation to make. Capital expenditures made by a lessor for the erection of buildings or other improvements shall, if subject to depreciation allowances, be recovered by him over the estimated life of the improvements without regard to the period of the lease.

(26 C.F.R., § 1.167(a)-4.)

§ 1.167(a)-5. *Apportionment of basis.*

In the case of the acquisition on or after March 1, 1913, of a combination of depreciable and nondepreciable property for a lump sum, as for example, buildings and land, the basis for depreciation cannot exceed an amount which bears the same proportion to the lump sum as the value of the depreciable property at the time of acquisition bears to the value of the entire property at that time. In the case of property which is subject to both the allowance for depreciation and amortization, depreciation is allowable only with respect to the portion of the depreciable property which is not subject to the allowance for amortization and may be taken concurrently with the allowance for amortization. After the close of the amortization period or after amortization deductions have been discontinued with respect to any such property, the unrecovered cost

or other basis of the depreciable portion of such property will be subject to depreciation. For adjustments to basis, see section 1016 and other applicable provisions of law. (26 C.F.R., § 1.167(a)-5.)

APPENDIX B.

OPINION OF THE UNITED STATES DISTRICT COURT.

GREEN, *District Judge*: This action was brought by plaintiffs, husband and wife, to recover $10,128.74 federal income taxes allegedly illegally and erroneously assessed and collected by the Commissioner of Internal Revenue for the years 1959, 1960 and 1961, with interest thereon. This action arises from the disallowance by the Commissioner of Internal Revenue of certain deductions which were claimed by the plaintiffs on their income tax returns for the said years. The deductions in question were based on costs of acquiring certain real estate and improvements which adjoined property which was under lease to the Kroger Company in Toledo, Ohio. Plaintiffs claimed that the purchase was made in order to obtain a renewal of an existing lease, which was about to expire.

Many of the facts pertinent to this action were stipulated by counsel. The facts herein as so stipulated and found by the Court, are as follows:

On September 28, 1949 the Benwell Corporation leased to the Kroger Company, a grocery chain, land identified as lots 149 through 153 in Knower's Addition in the City of Toledo, Ohio. The Benwell Corporation, in accordance with the terms of the lease, constructed a retail store on this land in which the Kroger Company carried

on a grocery retail operation. The basic term of this lease was from February 1, 1950 through January 31, 1955, with two 5-year renewal terms.

In January of 1953 Henry H. Bender and William G. Bender, d.b.a. the Benwell Company, became the owners and lessors of the property leased to the Kroger Company, in place of the Benwell Corporation. Henry H. Bender had an 80% interest in the Benwell Company and William G. Bender had the remaining 20% interest in said company.

On August 1, 1955 the lease of the premises to the Kroger Company was renewed for a 5-year renewal term, to expire July 31, 1960.

In June, 1959, about one year before the existing lease was to expire, the Kroger Company advised the lessors, Henry H. Bender and William G. Bender, that the lease would not be renewed unless the lessors could acquire certain property adjacent to that under lease for an additional parking area. The Kroger Company also contacted a real estate broker with regard to investigating other locations in the same general area for a retail grocery store. At the time the Kroger Company was contemplating moving from the Knower Street location the general area was experiencing a condition of declining commercial activity.

Upon being advised by the Kroger Company's representatives of their intent to move unless they could obtain an additional parking area, the lessors retained a real estate broker to enter into negotiations for the acquisition of residential property adjacent to that leased by the Kroger Company, to be acquired for such use.

The broker, a qualified real estate appraiser, appraised three residential properties which were adjacent to the leased premises. The three properties were known as 663,

669 and 671 Knower Street, and further described as lots 230 and 231 in Knower's Addition The broker appraised them as follows:

	Land	Buildings	Total
671 Knower Street	$1,300.00	$ 8,000.00	$ 9,300.00
669 Knower Street	1,300.00	16,200.00	17,500.00
663 Knower Street	1,500.00	9,000.00	10,500.00
Combined totals	$4,100.00	$33,200.00	$37,300.00

The broker discovered that the owners of these adjacent properties knew of the lessors' need to acquire them. He testified on this point:

> A. Well, I contacted the owners, and I found out that the manager of the Kroger store had been rather talkative. These people were clients of the Kroger store—to what extent, I don't know—but they had full knowledge that Kroger was going to acquire additional parking area, and they also had full knowledge that we could not go east because of this one particular party. So they felt that they were rather secure, in that we are going to pay their price.
>
> * * * * *
>
> Q. Did all the owners know that the Kroger Company and Mr. Bender were interested in acquiring or using the lots for parking?
>
> A. Yes, they were—which was very unfortunate.
>
> Q. Did they all use this knowledge in their bargaining over the price?
>
> A. I would think that they all did, yes. I'm quite sure that they did.
>
> Q. Was that mentioned in your discussions with all of the owners?
>
> A. Yes.

Following the said negotiations the lessors purchased lots 230 and 231 in Knower's Addition, with the three residents situated thereon. The purchases were consummated on or about November 9, 1959 as follows:

671 Knower Street	$30,946.52
669 Knower Street	27,895.98
663 Knower Street	15,845.05
Closing Costs	485.00
Total	$75,136.55

In addition to the above amounts, the lessors paid a real estate commission of $3,620.00 and a legal fee of $75.00 in conjunction with the said purchases.

Thereafter, the lessors razed the residences located on lots 230 and 231 at a cost of $1,790.00.

On September 22, 1959, the lease between the lessors and the Kroger Company was amended to include cleared land consisting of the parcels in question, although the purchases had not then been consummated, and to provide a basic lease term of January 1, 1960 through December 1, 1969, with three 5-year renewal terms.

The evidence indicated that the said lease renewal would not have been entered into by the Kroger Company if the lessors had not acquired lots 230 and 231 for use as additional parking facilities. The renewed lease provided for an increased rental, which over the ten-year period would amount to $74,400.00, virtually the amount of the lessors' cost of acquiring the additional parking area.

The Court finds that the great disparity between the appraised values and the purchase prices paid resulted from the adjacent land owners' knowledge of the necessity of the lessors acquiring the said lots in order to preserve their lease with the Kroger Company.

The plaintiffs, for income tax purposes, considered the cost of acquiring the buildings, $71,036.55 ($75,136.55, minus $4,100.00 for the land) plus the cost of razing, $1,790.00, for a total of $72,826.55, as being chargeable against the acquisition of the renewed lease, to be amortized over a period of 124 months.

The plaintiffs herein deducted their percentage share of the amortized expenses, as set forth above, for the years 1959, 1960 and 1961. In addition, for the year 1959 the real estate commission in the amount of $3,620.00 and the legal fees of $75.00 were deducted as expenses by the lessors, with the plaintiffs claiming their percentages as deductions for 1959.

The Internal Revenue Service disallowed as deductions for amortized leasehold expenses the amounts claimed by plaintiffs for the three years, along with the sale expenses deducted for 1959, and assessed income tax deficiencies in the following amounts:

1959	$1,755.94
1960	3,396.36
1961	4,976.44

The plaintiffs paid the amounts assessed, with interest, filed timely claims for refund, and thereafter brought this action to recover the same.

It is plaintiffs' contention that the costs of acquiring and razing the buildings on lots 230 and 231, Knower's Addition, were incurred solely for the purpose of obtaining a renewal of the existing lease with the Kroger Company, thus qualifying for a deduction under Sections 162 and 212, and a depreciation of the deduction under Section 167, Internal Revenue Code of 1954.

The code sections upon which plaintiffs rely are, in pertinent part, as follows:

U. S. C. Sec. 162. *Trade or Business Expenses*

(A) In General.—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—

* * * * *

(3) Rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity * * *.

26 U. S. C. Sec. 212. *Expenses for Production of Income*

In the case of an individual, there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year * * *.

(1) for the production or collection of income;

(2) for the management, conservation, or maintenance of property held for the production of income; * * *

26 U. S. C. Sec. 167. *Depreciation*

(a) General Rule.—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

(1) of property used in the trade or business, or

(2) of property held for the production of income.

Defendant contends that costs attributable to buildings purchased with the intent of razing the same should not be amortized over the life of the lease, but should be allocated to the land instead, relying on Treasury Regulations on Income Tax (1954 Code) 1.165-3, 26 C. F. R., Sec. 1.165-3, promulgated under 26 U. S. C. § 165.

Before considering the merits of the legal issues presented, there is one factual controversy that must be resolved.

Defendant suggests that the lessors' purchase of lots 230 and 231 was not solely for the purpose of protecting the Kroger lease, in that it was generally beneficial to the

lessors to acquire the said property. While it is likely true that the additional adjacent space enhanced the value of the land already owned by the lessors, there is no evidence that they would have purchased lots 230 and 231 if the Kroger Company had not threatened to vacate, and no evidence was introduced to show any increase in value to the originally leased property by reason of the purchase of the adjacent parcels. The Court, therefore, finds that the purchase of lots 230 and 231 by the lessors was for the purpose of securing the lease renewal from the Kroger Company.

The question for determination in this case appears to be as follows: May a lessor of real property who, in order to preserve an existing lease and secure a renewal thereof, purchases adjacent improved real property, with the intent to demolish the buildings thereon in order to make the acquired property suitable for the lessee's use, amortize his expenditures over and above the appraised fair market value of the raw land, as an expense incurred for the production or collection of income or for the management, conservation or maintenance of property held for the production of income.

Briefs of counsel and independent research have not disclosed any cases on this precise question.

Defendant contends that Regulation 1.165-3 requires a negative answer to this proposition. That regulation, in pertinent part, provides:

> Sec. 1.165-3. *Demolition of Buildings*
>
> (a) Intent to demolish formed at time of purchase.
>
> (1) * * * the following rule shall apply when, in the course of a trade or business or in a transaction entered into for profit, real property is purchased with the intention of demolishing either immediately or subsequently the buildings situated thereon:

No deduction shall be allowed under section 165(a) on account of the demolition * * *. The entire basis of the property so purchased shall, notwithstanding the provisions of § 1.167(a)-(5), be allocated to the land only. Such basis shall be increased by the net cost of demolition or decreased by the net proceeds from demolition.

* * * * *

(b) *Intent to demolish formed subsequent to acquisition.*

(1) Except as provided in subparagraph (2) of this paragraph, the loss incurred in a trade or business or in a transaction entered into for profit and arising from a demolition of old buildings shall be allowed as a deduction under section 165(a) if the demolition occurs as a result of a plan formed subsequent to the acquisition of the buildings demolished. * * *

(2) If a lessor or lessee of real property demolishes the buildings situated thereon pursuant to the requirements of a lease or the requirements of an agreement which resulted in a lease, no deduction shall be allowed to the lessor under section 165(a) on account of the demolition of the old buildings.

However, the adjusted basis of the demolished buildings, increased by the net cost of demolition or decreased by the net proceeds from demolition, shall be considered as a part of the lease to be amortized over the term thereof.[1]

The flaw in defendant's position is that the subject regulation was promulgated under, and pertains to, section

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[1] While a cursory reading of the regulation might indicate that plaintiffs' position is sustained by subsection (b) (2) thereof, defendant argues, and the Court believes, that the subsection must be read as a qualification to subsection (b) (1), which applies only where the intent to demolish is not present at the time of acquisition. On the facts of this action, the intent to demolish did exist at the time of acquisition. Hence, subsection (b) of the regulation could not apply herein.

165 of the Internal Revenue Code of 1954, 26 U. S. C. § 165, which relates to the deduction of losses.[2] That is not the point in issue here. Plaintiffs are not attempting to deduct the loss in full for the year 1959, but rather are attempting to amortize the expenditure over the term of the lease. Consequently, the Court is of the opinion that the regulation does not control herein.

Defendant argues that the regulation should be applied against the claimed deductions under 26 U. S. C. § 167, in that it is the only regulation in Part VI of Subchapter B of the Internal Revenue Code which deals with "Demolition of Buildings." In support of this argument counsel further contends that the regulation promulgated under Section 165 makes both explicit and implied reference to Section 167 which section deals with deductions for depreciation.

The Court does not believe that a tax regulation dealing with the subject of "demolition of buildings," is applicable in every instance where "demolition of buildings" is involved, regardless of whether the claimed deduction which is the specific subject of the regulation is at issue. We are here concerned with a claim of the right to depreciate an alleged business expense over a period of years, whereas the regulation under Section 165 covers claims of a loss in a single year for the same or similar type of expense. It is the Court's opinion that the absence of a controlling regulation does not justify the application of an existing one dealing with a different type of deduction.

As to the cross-references in Regulation 1.165-3 to Section 167, in the Court's opinion they do not support defendant's arguments, nor are they reflective of an intent

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[2] 26 U. S. C. Sec. 165 *Losses*

(a) General Rule.—There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

that the said regulation have application to claims of a right to a depreciation deduction under Section 167.

The express reference in Regulation 1.165-3 to Section 167 is set forth in subsection (a)(1) of the said regulation as follows:

> * * * The entire basis of the property so purchased shall, notwithstanding the provisions of § 1.167(a)-5, be allocated to the land only * * *

The defendant in its brief contends that from this reference,

> * * * it would appear that when property is bought with the intention formed at the time of purchase to raze the buildings thereon, the entire basis of the property so purchased must be allocated to the land only. Since land is non-depreciable, then no deduction of any kind would be allowable at any time for any part of the purchase price.

This Court has considered the pertinent regulations adopted under both Sections 165 and 167, and is of the belief that the scope ascribed to regulation 1.165-3 by the Government is not reflected therein. In the Court's opinion, the specific cross-reference here under consideration is to make clear that no loss in full during a single year can be claimed under Section 165 under the circumstances described in the said regulation, whereas the regulation promulgated under Section 167 alone might have left the right to claim such a deduction under Section 165 subject to question.

The implied reference to Section 167 upon which defendant relies in support of its argument that Sections 165 and 167 are interrelated is found in subsection (b)(2) of Regulation 1.165-3, previously set forth herein, which provides that the allowable deduction for demolition of

buildings pursuant to a lease agreement is to be in the form of amortization of the expenses incurred over the term of the lease.

In the Court's opinion, subsection (b) (2) of Regulation 1.165-3 does not rule out the propriety of a claim for depreciation over the term of a lease where the intent to demolish existed at the time the property was purchased. Subsection (b) (2) is predicated on the supposition that the intent to demolish the building arose after acquisition of the property. The said subsection is a part of an entire regulation adopted under the Internal Revenue Code section dealing with the right to claim a loss in full in the year of the alleged loss and is significant only in the respect that it supports plaintiffs' contention that costs of demolition may, under given circumstances, be chargeable against the acquisition of a lease.

There is a well established rule that is the focal point of this controversy—expenses incurred by a lessor in securing a long-term lease are properly amortized over the term of the lease. *Wolan v. Commissioner* [50-2 USTC ¶ 9424], 184 F. 2d 101 (CA 10, 1950); *Spinks Realty Co. v. Burnet* [1932 CCH ¶ 9560], 62 F. 2d 860 (CA D. C., 1932); *Harry Latter v. Commissioner* [CCH Dec. 24,710 (M)], 20 T. C. M. 336 (1961). The theory behind allowing such a deduction was set forth in *Cosmopolitan Corp. v. Commissioner* [CCH Dec. 23,642(M)], 18 T. C. M. 542 (1959) wherein it was stated:

> Where, as here, however, the leases are being terminated in order either to erect a new structure or to obtain a new long term lease extending substantially beyond the old tenancy, the landlord has acquired a new assets which he did not previously possess. With respect to it, the cost of eliminating the old lease, like the loss on demolition of old structures * * * or the expense of building material, or any

> other factor contributing to the new asset, * * * is a capital expenditure to be amortized over the life of the newly acquired property.

The real point in issue herein is whether the deductions claimed by plaintiffs come within this rule. It is the Court's opinion that they do.

At the time that the lessors purchased lots 230 and 231, and demolished the buildings thereon, they were faced with the threatened loss of an existing tenant. The general economic condition of realty in the area was declining, and the lessors would be left with a vacant property. In order to retain their tenant, and acquire a new long-term lease, the lessors bought, at a premium, land which they otherwise would not have acquired, and altered it to the use required by the lessee. The Court believes that in so doing, the lessors were making an investment over and above the value of the land which was attributable to the retention and production of their business income, and that they are entitled to a proper deduction therefor for income tax purposes.

The only case cited by counsel which bears on the issue here under consideration is the ruling in *Camp Wolters Land Co. v. Commissioner* [47-1 USTC ¶ 9184], 160 F. 2d 84 (CA 5, 1947).

In that case, the City of Mineral Wells, Texas had leased certain lands from the owners thereof, and had subleased the lands to the United States for use as an Army Camp. When it was determined that the United States needed additional lands, the City was without funds to acquire them. The plaintiff corporation therein was formed by private citizens to purchase the added property, which was to be leased to the City and sub-leased to the United States. It was then determined that certain improvements on lands neither owned nor leased by the City or the cor-

poration would have to be purchased and destroyed, in order that the large tract be suitable for the use of the United States. The corporation bought the improvements and had the same demolished and removed at a loss to it. It was necessary to purchase and remove the buildings in order to secure the United States as a tenant and to realize on the lease.

The taxpayer claimed a loss for income tax purposes, which was disallowed by the Commissioner of Internal Revenue. The action of the Commissioner was sustained by the Tax Court.

On appeal from the decision of the Tax Court, the Fifth Circuit Court of Appeals held:

> That the loss of $6,650.00 occasioned by the purchase, demolition and removal of the improvements on the Deakins, Maddox, and Sullivan tracts were an expense incident to securing the lease and obtaining a tenant that should be amortizable over the life of the lease * * * [47-1 USTC ¶ 9184] 160 F. 2d 84, 89.

Defendant herein distinguishes the *Camp Wolters* case on the ground that no land was purchased therein. The defendant states in its brief:

> Because the Camp Wolters Company did not purchase the land, the case is substantially different from the case under consideration here. Here, the costs were allocable to the land; in the Camp Wolters situation, there was no land to which the cost could be applied.

This argument is reflective of the general theory upon which the defendant has proceeded in this case—when a taxpayer purchases real property, improved or unimproved, that is intended to be used as unimproved land, the entire purchase price must be allocated to the basis of the land and no part thereof may be allocated to a wasting asset.

A similar contention by the Commissioner has been rejected in the case of *Millinery Center Building Corp. v. Commissioner* [56-1 USTC ¶ 9391], 350 U. S. 456 (1956). Therein, the taxpayer leased certain real property, on which it had constructed a commercial building. Although the taxpayer held legal title to the building during the term of the lease, it was to revert to the lessor upon the expiration of the lease, at the lessor's option. The Supreme Court stated that the taxpayer's claim that it "owned" the building was based on a loose and misleading use of "owned," id. p. 459. The taxpayer purchased the fee title to the land it leased, for the sum of $2,100,000. At the time of purchase the value of the raw land was $660,000. The taxpayer attempted to claim a deduction for the $1,440,000 difference between the purchase price and land value.

The Commissioner ruled that the entire purchase price must be allocated to the land, and his position was sustained in the Tax Court [CCH Dec. 20,180], 21 T. C. 817 (1954). The Court of Appeals reversed the Tax Court [55-1 USTC ¶ 9377], 221 F. 2d 322 (CA 2, 1955), holding that the purchase price could be divided between land and an interest in the improvements thereon, to be amortized over the useful life of the building. An appeal was taken by the taxpayer to the Supreme Court, 350 U. S. 820 (1955). The Commissioner did not appeal the ruling of the Court of Appeals. Therefore, the correctness of the decision permitting the allocation between land and a depreciable wasting asset was not strictly before the Supreme Court. The opinion of the Supreme Court clearly indicates, however, that it believed the ruling below to be correct, and affirmed the same on the questions presented.

Similar to the circumstances of the *Millinery Center Building* case is the decision in *World Publishing Co. v. Commissioner* [62-1 USTC ¶ 9282], 299 F. 2d 614 (CA 8, 1962). There again, the contention of the Commissioner that a purchase of land cannot result in an allocation between a capital asset and a wasting asset was rejected.

The taxpayer purchased a piece of land, which was subject to a lease to a third person, for $700,000. The lessee had constructed a building thereon, which by the terms of the lease became a part of the realty and reverted to the lessor at the expiration of the lease. The appraised value of the land was $400,000. The taxpayer sought to amortize the $300,000 difference over the term of the lease, while the Commissioner contended that the $700,000 should be allocated to the land basis.

The Court of Appeals held that the taxpayer had acquired both a capital asset and a wasting asset, and sustained the taxpayer's position.

It is the Court's opinion that the philosophy of the foregoing cases is applicable herein. For their expenditure of over $70,000 the lessors acquired a capital asset, land, with an appraised value of $4,100.00, as testified by plaintiffs' expert. The balance of the expenditure was motivated by, and attributable to, the securing of the new lease from the Kroger Company. It therefore follows that such excess investment should be chargeable against the lease, under 26 U. S. C. § 167, as a wasting asset.

At the trial the Court inquired whether the defendant would offer evidence of other appraisers as to the value of the land. Counsel for defendant stated that the Government would introduce no expert evidence with its own expert appraiser on values. The defendant did not rebut the evidence as to the appraisal value of the land offered

by plaintiffs. Therefore, the Court is bound to accept the evidence as reflected in the record, for as was said in *World Publishing Co. v. Commissioner, supra,* at p. 623:

> The Commissioner had his opportunity in the proceedings which have already taken place * * * to controvert the taxpayer's evidence. This he did not do but chose, instead, to rely on his basic thesis that the taxpayer had no investment which was entitled to depreciation.

It is the Court's conclusion that plaintiffs are entitled to the deductions for amortization in the amounts as claimed for the years 1959, 1960 and 1961.

As to the real estate commissions and legal fees deducted in full for the year 1959, those items are also chargeable against the lease and should be amortized over the term thereof. *Spinks Realty Co. v. Burnet* [1932 CCH ¶ 9560], 62 F. 2d 860 (CA D. C. 1932); *Renwick v. United States* [37-1 USTC ¶ 9010], (1937). The deficiencies assessed against plaintiffs are, therefore, subject to recomputation based on such amounts.

Decision is entered in favor of plaintiffs in accordance with the terms of this memorandum opinion, which is adopted as Findings of Fact and Conclusions of Law, pursuant to Rule 52, Federal Rules of Civil Procedure. Counsel for the respective parties shall confer on the amount of verdict to be entered in favor of plaintiffs herein, with interest as prayed for, and submit such figure to the Court for rendition of a final judgment.

APPENDIX C.

OPINION OF THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT.

(Decided September 28, 1967.)

Before: WEICK, Chief Judge, EDWARDS, Circuit Judge, and CECIL, Senior Circuit Judge.

EDWARDS, Circuit Judge. This is an appeal by the United States of America from a District Court judgment in favor of the plaintiffs for a refund of taxes and deficiency interest paid under protest in 1959, 1960 and 1961 in the sum of $7,425.77.

The taxpayer-plaintiffs in this case owned an 80% interest in five lots in Toledo, Ohio, which had been leased to the Kroger Company for a grocery operation. When the time approached for renewal, Kroger notified the lessors that additional parking was essential for renewal of the lease. Thereupon the lessors negotiated through a real estate broker for the purchase of two adjacent lots on which three houses were located. The sellers knew of Kroger's need for additional parking and the purchase prices ultimately paid were substantially in excess of the values of the lots and buildings as appraised by the plaintiffs' realtor. The comparison of appraisals to purchase prices is shown below:

	Appraisal Prices			Purchase
	Land	Buildings	Total	Prices
671 Knower St.	$1,300.00	$ 8,000.00	$ 9,300.00	$30,946.52
669 Knower St.	1,300.00	16,200.00	17,500.00	27,859.98
663 Knower St.	1,500.00	9,000.00	10,500.00	15,845.05
Closing Costs				485.00
Total	$4,100.00	$33,200.00	$37,300.00	$75,136.55

In addition to the above amounts, the lessors paid a real estate commission of $3,620 and a legal fee of $75 in conjunction with the said purchases.

Thereafter, the lessors razed the residences located on lots 230 and 231 at a cost of $1,790.

The Kroger Company renewed the lease on terms which compensated lessors for the costs of acquisition of the parking lot property.

The taxpayers sought to amortize their share (80%) of their expenditures above the $4,100 appraised value of the land involved over the term of the lease in their tax returns for 1959, 1960 and 1961. Their basic claim was that the expenditures for the buildings and their demolition (a sum of $80,621.55)[1] should be regarded as expenses incurred for the production of income under section 212 of the Internal Revenue Code, or as ordinary business expense under Section 162 of the Code.

The Internal Revenue Service disallowed the claimed deductions on the ground that these expenditures were capital expenditures which had to be allocated solely to the land. The taxpayers paid the amounts assessed and sued in the United States District Court for refund of approximately $7,500 for taxes and deficiency interest paid.

The District Judge heard the case on the stipulated facts which we have recited. He found:

> "[T]he great disparity between the appraised values and the purchase prices paid resulted from the adjacent land owners' knowledge of the necessity of the lessors acquiring the said lots in order to preserve their lease with the Kroger Company." *Bender v. United States,* 246 F. Supp. 189, 192 (N.D. Ohio 1965).

* * *

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[1] Included in this figure were a real estate commission in the amount of $3,620 and legal fees of $75 incurred in connection with the purchase of the property, 80% of which the lessor-taxpayers sought to deduct as business expense in 1959.

"[T]he purchase of lots 230 and 231 by the lessors was for the purpose of securing the lease renewal from the Kroger Company." *Bender v. United States, supra* at 193.

He stated the question posed by this case as follows:

"May a lessor of real property who, in order to preserve an existing lease and secure a renewal thereof, purchases adjacent improved real property, with the intent to demolish the buildings thereon in order to make the acquired property suitable for the lessee's use, amortize his expenditures over and above the appraised fair market value of the raw land, as an expense incurred for the production or collection of income or for the management, conservation or maintenance of property held for the production of income." *Bender v. United States, supra* at 193.

The District Judge answered this question in favor of the taxpayers. He appears to have relied primarily upon 26 U.S.C. § 167 which says:

"Sec. 167 *Depreciation.*

"(a) General Rule.—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

"(1) of property used in the trade or business, or

"(2) of property held for the production of income * * *."

26 U.S.C. § 167 (1958).

Citing and relying on *Camp Wolters Land Co. v. Commissioner,* 160 F.2d 84 (C.A. 5, 1947); *Millinery Center Building Corp. v. Commissioner,* 350 U.S. 456 (1956); and *World Publishing Co. v. Commissioner,* 299

F.2d 614 (C.A. 8, 1962),[2] the District Judge's opinion said:

> "It is the Court's opinion that the philosophy of the foregoing cases is applicable herein. For their expenditure of over $70,000 the lessors acquired a capital asset, land, with an appraised value of $4,100.00, as testified by plaintiffs' expert. The balance of the expenditure was motivated by, and attributable to, the securing of the new lease from the Kroger Company. It therefore follows that such excess investment should be chargeable against the lease, under 26 U.S.C. § 167, as a wasting asset." *Bender v. United States*, 246 F. Supp. 189, 197 (N.D. Ohio 1965).

We are unable to agree with this conclusion. Here it appears clear that the lessor-taxpayers were seeking to clear and join together two plots previously used for three residences in order to convert them to a commercial use for parking in conjunction with their store property. The intention to demolish the dwellings existed at the time of acquisition as the District Judge noted.

Land, of course, is a nondepreciable asset. The cost of land alone cannot be depreciated over the life of a lease. Treas. Reg. § 1.167(a)-2 (1956); *Hoboken Land & Improvement Co. v. Commissioner*, 138 F.2d 104, 106 & n. 2 (C.A. 3, 1943); 4 J. Mertens, The Law of Federal Income Taxation §§ 23.09, 23.12 (1966 rev.).

There is also a well established rule that the total cost of realty purchased shall be allocated to the land alone when at the time of purchase the buildings thereon are in-

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[2] We believe these cases are not sufficiently similar on their facts to be given the weight the District Court Judge gave them as precedent for his decision. In *Wolters* the taxpayers purchased and demolished buildings—but they were not the owners of and did not purchase the land. And the *Millinery* and *World Publishing* cases did not involve any question of building demolition.

tended to be demolished. *Providence Journal Co. v. Broderick*, 104 F.2d 614 (C.A. 1, 1939); *Liberty Baking Co. v. Heiner*, 37 F.2d 703 (C.A. 3, 1930); *Montgomery Co. v. Commissioner*, 330 F.2d 950 (C.A. 6, 1964); *Lesser v. Commissioner*, 42 T.C. 688 (1964), *aff'd*, 352 F.2d 789 (C.A. 9, 1965), *cert. denied*, 384 U.S. 927 (1966), *motion to remand denied*, 384 U.S. 982 (1966).

In the last cited case the Tax Court said in part:

> "[T]he rule has long been established that where one purchases property with intention of demolishing or removing a structure, that portion of the purchase price otherwise allocable to the demolished part must be treated as allocated to the remaining property. Cf. *Blumenfeld Enterprises*, 23 T.C. 665, 670, affirmed, 232 F.2d 396 (C.A. 9); *Lynchburg National Bank & Trust Co.*, 20 T.C. 670, 673-674, affirmed on another ground 208 F.2d 757 (C.A. 4); *Hillside National Bank*, 35 T.C. 879; *N. W. Ayer & Son, Inc.*, 17 T.C. 631, 635." *Lesser v. Commissioner*, 42 T.C. 688, 705 (1964).

And in the *Providence Journal* case, the Court of Appeals for the First Circuit said:

> "The intention at the time of the purchase fixes the nature of the transaction. The taxpayer here desired to buy a certain lot for the erection of a new building. To get the lot it was necessary to take the buildings on it. After the land had been cleared, at the commencement of the new construction which the taxpayer had in view from the beginning, the lot stood the taxpayer the cost of the land and buildings plus the cost of removing the then useless buildings." *Providence Journal Co. v. Broderick*, 104 F.2d 614, 616 (C.A. 1, 1939).

Business losses and depreciation of property are dealt with in the Internal Revenue Code in sections 165 and 167 respectively:

"SEC. 165. LOSSES.

"(a) *General Rule*.—There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

"(b) *Amount of Deduction.*—For purposes of sub-section (a), the basis for determining the amount of the deduction for any loss shall be the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property.

"(c) *Limitation on Losses of Individuals.*—In the case of an individual, the deduction under subsection (a) shall be limited to—

"(1) losses incurred in a trade or business;

"(2) losses incurred in any transaction entered into for profit, though not connected with a trade or business; * * *" 26 U.S.C. § 165 (1958).

* * *

"SEC. 167 DEPRECIATION.

"(a) *General Rule.*—There shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence)—

"(1) of property used in the trade or business, or

"(2) of property held for the production of income.

* * *

"(f) *Basis For Depreciation.*—The basis on which exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the adjusted basis provided in section 1011 for the purpose of determining the gain on the sale or other disposition of such property." 26 U.S.C. § 167 (1958).

And there is a Treasury Regulation which deals directly with demolition of buildings. This first part of this regulation provides:

"Treasury Regulations on Income Tax (1954 Code):

"§ 1.165-3. *Demolition of buildings.*

"(a) *Intent to demolish formed at time of purchase.* (1) Except as provided in subparagraph (2) of this paragraph, the following rule shall apply when, in the course of a trade or business or in a transaction entered into for profit, real property is purchased with the intention of demolishing either immediately or subsequently the buildings situated thereon: No deduction shall be allowed under section 165(a) on account of the demolition of the old buildings even though any demolition originally planned is subsequently deferred or abandoned. The entire basis of the property so purchased shall, notwithstanding the provisions of § 1.167(a)-5, be allocated to the land only. Such basis shall be increased by the net cost of demolition or decreased by the net proceeds from demolition." Treas. Reg. § 1.165-3 (1960).

The District Judge felt that this regulation was not applicable since it related directly to section 165 which dealt with "Losses." The District Judge apparently felt that the purchase of realty with the intention to demolish buildings thereon did not result in a "loss." In this view we agree.

We do not, however, agree that the quoted regulation is as limited in application as the District Judge felt it was. The regulation appears to be designed to deal generally with the problem of demolition of buildings—particularly when the intent to demolish is formed at the time of purchase. In addition, the last two sentences of the quoted paragraph with their reference to section 1.167(a)-5 appear clearly to reject depreciation or amortization of such costs.

"The entire basis of the property so purchased shall, notwithstanding the provisions of § 1.167(a)-5,

be allocated to the land only. Such basis shall be increased by the net cost of demolition or decreased by the net proceeds from demolition." Treas. Reg. § 165-3 (1960).

We regard these sentences as intended to negate any possible application of depreciation or amortization under the facts of this case.

The remaining question is then whether or not Reg. 1.165-3 is a reasonable interpretation of the Int. Rev. Code of 1954—particularly in view of section 167 relied upon by the District Judge and sections 212 and 162 cited by appellant. We believe that it is.

Regulation 1.165-3 is a new version of an older regulation which was first promulgated in 1921:

"Art. 142. *Voluntary removal of buildings.* —* * *

"When a taxpayer buys real estate upon which is located a building which he proceeds to raze with a view to erecting thereon another building, it will be considered that the taxpayer has sustained no deductible loss by reason of the demolition of the old building, and no deductible expense on account of the cost of such removal, the value of the real estate, exclusive of old improvements, being presumably equal to the purchase price of the land and buildings plus the cost of removing the useless building." Treas. Reg. 45, Art. 142 (1921).

Both the length of time this general administrative interpretation has been in effect and the fact that in the intervening years Congress has not amended the Internal Revenue Code to alter this interpretation are due some weight in our consideration of our instant problems. See, e.g., *Cammarano v. United States,* 358 U.S. 498, 510-11 (1959); *Fribourg Navigation Co. v. Commissioner,* 383 U.S. 272, 283 (1966).

We believe the weight of authority supports both our holding that Reg. 1.165-3 is a reasonable regulation and that it is applicable to the present facts. *Providence Journal Co. v. Broderick,* 104 F.2d 614 (C.A. 1, 1939); *Liberty Baking Co. v. Heiner,* 37 F.2d 703 (C.A. 3, 1930); *Montgomery Co. v. Commissioner,* 330 F.2d 950 (C.A. 6, 1964).

The decision of the District Court in the instant case has been the subject to critical consideration in an interesting comment in 65 Mich. L. Rev. 366 (1966) and in an opinion by the United States District Court in Massachusetts which was subsequently affirmed by the Court of Appeals for the First Circuit. *Meyers v. United States,* 247 F. Supp. 939 (D. Mass. 1965), *aff'd per curiam,* 362 F.2d 264 (C.A. 1, 1966). The First Circuit view is clearly in favor of giving effect to Treasury Regulation § 1.165-3.

We hold that Reg. § 1.165-3 is a reasonable interpretation of Internal Revenue Code §§ 165 and 167 and that it should have been applied in this case. As a matter of law, plaintiffs were not entitled to the refunds they sought.

Reversed and remanded for dismissal of the complaint on the merits and the entry of judgment for defendant.

APPENDIX D.

JUDGMENT OF THE UNITED STATES COURT OF APPEALS.

(Entered September 28, 1967.)

APPEAL from the United States District Court for the Northern District of Ohio.

THIS CAUSE came on to be heard on the record from the United States District Court for the Northern District of Ohio and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be and the same is hereby reversed and the case remanded for dismissal of the complaint on the merits and the entry of judgment for defendant.

No costs awarded. Rule 23(4).

Entered by order of the Court.

CARL W. REUSS,
Clerk.

APPENDIX E.

ORDER DENYING MOTION FOR REHEARING.

(Filed November 13, 1967.)

Before: WEICK, Chief Judge, EDWARDS, Circuit Judge, and CECIL, Senior Circuit Judge.

On consideration of the motion for rehearing filed in the above-styled appeal, the same is hereby denied.

Entered by order of the Court.

CARL W. REUSS,
Clerk.

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No. 1031

In the Supreme Court of the United States

OCTOBER TERM, 1967

HENRY H. BENDER AND MYRTLE BENDER, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

ERWIN N. GRISWOLD,
Solicitor General,
MITCHELL ROGOVIN,
Assistant Attorney General,
DAVID G. WALTER,
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Department of Justice,
Washington, D.C. 20530.

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MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

Petitioner[1] owned an 80 percent interest in real estate that was leased to the Kroger Company, which used it in a grocery operation. At the end of the lease term, Kroger insisted that additional parking facilities be provided as a condition of renewal. The lessors therefore purchased two adjacent lots on which were three houses. Because the sellers knew of Kroger's need for parking facilities, the purchase price of some $75,000 was more than twice the value of the lots and buildings as appraised by petitioner's realtor. After the purchase, the lots were cleared, and, together with the original premises, leased to Kroger for

[1] Mrs. Bender is a party only because joint returns were filed, and Mr. Bender will be referred to as the petitioner.

a 10-year term, at a rental that was designed to compensate the lessors for the cost of acquiring the adjacent lots. (Pet. 23a–24a.)

In his tax returns for 1959 through 1961, petitioner sought to amortize, as his share of the alleged cost of the [redacted] demolished buildings, 80 percent of all expenditures, including the cost of demolition and attorney's fees, above the $4,100 value the lessors' realtor assigned as the value of the land. Those amounts were claimed to be expenses incurred for the production of income within the meaning of Section 212 of the Internal Revenue Code, or ordinary business expenses under Section 162 of the Code. (Pet. 24a.)

The Commissioner of Internal Revenue disallowed the claim on the theory that the entire expenditures were expenditures which should be allocated solely to the land. Petitioner paid the deficiencies assessed. The district court ruled in his favor in his resulting suit for refund, but the court of appeals reversed.[2]

This decision is correct. There is no conflict or any other basis for review in this Court.

Land is concededly not a depreciable asset. The only question here is how much of the lessors' purchase price should be allocated to the land. The case is controlled by Section 1.165–3 of the income tax Regulations under the 1954 Code, the basic provisions of which may be traced back to Article 142 of Treas. Regs. 45 (1919 ed.), promulgated under the Revenue Act of 1918, c. 18, 40 Stat. 1057. The regulation provides that when a taxpayer purchases improved real estate with the intention of demolishing the structures, the entire

[2] The opinion of the court of appeals is reported at 383 F. 2d 656.

cost of the property, including his cost of demolition, is the actual cost of acquiring the land and should be allocated to it. The only allowable depreciation can be with respect to the cost of whatever structure is erected on the land after clearance. There is no dispute over the fact that petitioner and the other lessors who purchased these properties had the requisite intention when they purchased the property.[3] The courts are unanimous in holding that in this situation the regulation requires the result reached below, see *e.g., Meyer* v. *United States,* 247 F. Supp. 939 (D. Mass.), affirmed *per curiam,* 362 F. 2d 264 (C.A. 1).

Petitioner contends (Pet. 7–9) that the Regulation Section 1.165–3 deals only with losses and not with amortization. However, that contention ignores the wording of the regulation, which plainly requires that in a situation such as the one at bar the entire cost must be allocated to the land alone.

There is no conflict with *Camp Wolters Land Company* v. *Commissioner,* 160 F. 2d 84 (C.A. 5). There the taxpayer purchased buildings but not the underlying land, which others owned. Regulation Section 1.165–3 of necessity applies only when land and improvements are purchased together.

Nor does petitioner have a wasting asset amortizable over the 10-year term of his leasehold. To be sure, the capital costs incurred in securing a new lease or insuring the renewal of an existing lease may be in appropriate circumstances amortized over the term of the lease. Thus in *Post* v. *Commissioner,* 109 F. 2d 135 (C.A. 2),

[3] Thus there is no merit to petitioner's claim (Pet. 9–10) that the court of appeals improperly overturned a material factual finding of the district court.

the taxpayer was allowed to amortize his cost basis, less previously claimed depreciation, in a structure he demolished at the insistance of a prospective lessee. But there the intention to demolish did not arise until some time after the property was purchased, so that the long standing provision of Regulation Section 1.165.3 did not require, as it does here, the allocation of such amounts to the cost basis of land, which is plainly a nonwasting asset as to which neither depreciation nor amortization may be taken.[4] See, also, *Spinks Realty Co.* v. *Burnet,* 62 F. 2d 860 (C.A.D.C.). In the instant case, however, the land was purchased with the intention to demolish the buildings.

The petition for a writ of certiorari should be denied.

Respectfully submitted.

ERWIN N. GRISWOLD,
Solicitor General.
MITCHELL ROGOVIN,
Assistant Attorney General.
DAVID O. WALTER,
LORING W. POST,
Attorneys.

FEBRUARY 1968.

[4] Petitioner here has made no showing that a discrete part of the price he and his co-lessors paid was the cost of intangible property that would have no value at the end of Kroger's renewal term. Compare Rubin, *Depreciation of Property Purchased Subject to a Lease*, 65 Harv L. Rev. 1134 (1952). See, also, Casenote, 65 Mich. L. Rev. 366, 371–372. Accordingly, there is no basis in this record for a contention that part of the purchase price can be isolated as the cost of an independent wasting intangible asset with a useful life limited to the term of the lease.

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